

ORIGINAL

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT ON EXAMINATION

as of

DECEMBER 31, 2002

of the

HEALTH INSURANCE CORPORATION OF ALABAMA
MONTGOMERY, ALABAMA

PARTICIPATION:

Alabama

EXAMINATION AFFIDAVIT

STATE OF ALABAMA

COUNTY OF MONTGOMERY

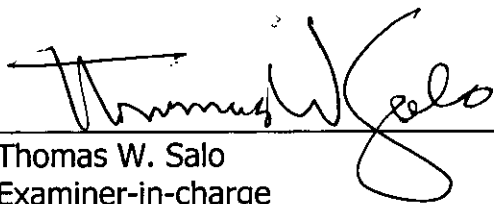
Thomas W. Salo being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Health Insurance Corporation of Alabama for the period of January 1, 1998 through December 31, 2002;

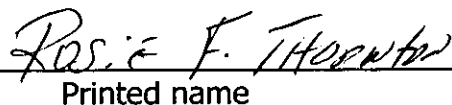
That the following 26 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.


Thomas W. Salo
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this 3rd day of May, 2004.


(Signature of Notary Public)


Printed name

Notary Public

in and for the State of Alabama

My commission expires 9/10/05

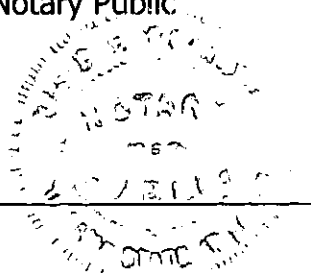


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GOVERNOR

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Montgomery, Alabama
May 3, 2004

WALTER A BELL
COMMISSIONER
DEPUTY COMMISSIONER
JAMES R. (JOHNNY) JOHNSON
D DAVID PARSONS
CHIEF EXAMINER
RICHARD L. FORD
STATE FIRE MARSHAL
JOHN S. ROBISON
GENERAL COUNSEL
MICHAEL A. BOWNES
RECEIVER
DENISE B. AZAR
PRODUCER LICENSING MANAGER
JIMMY W. GUNN

Honorable Walter A. Bell
Commissioner of Insurance
State of Alabama
P.O. Box 303350
Montgomery, Alabama 36130-3350

Dear Commissioner Bell:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and financial condition of the

**Health Insurance Corporation of Alabama
Montgomery, Alabama**

at its home office located at 301 Brown Springs Road, Montgomery, Alabama, as of December 31, 2002. The report of examination is submitted herewith.

Where the description "Company" appears herein without qualification, it will be understood to indicate Health Insurance Corporation of Alabama.

SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized by the Insurance Commissioner of the State of Alabama pursuant to the statutory requirements of the *Alabama Insurance Code* and the bulletins and regulations of the Alabama Department of Insurance (ALDOI). The examination was made in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC) and in agreement with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination reported herein covers the period from December 31, 1997 through December 31, 2002, and has been conducted by examiners representing the State of Alabama. Events subsequent to December 31, 2002, have been reviewed, and are reported herein, as deemed appropriate.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods, and a general review of records and files pertaining to operations, administrative practices, and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2002 as shown in the Financial Statements contained herein. The discussion of specific assets or liabilities contained in this report is confined to those items where a change was made by the examiners; or which indicated violation of the *Alabama Insurance Code* or the rules and regulations of the Alabama Department of Insurance; or other insurance laws or rules; or which were deemed by the examiners to require comments and/or recommendations.

In compliance with requirements of the Alabama Department of Insurance, the appropriate official of the Company executed a letter of representation certifying that the Company had valid title to all its reported assets and that it did not have unreported liabilities as of December 31, 2002.

A Company office copy of the filed annual statement for the year 2002 was compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, policyholder complaints, treatment of claimants, advertising and marketing, and compliance with agents' licensing requirements.

The Company's accounts were audited by Wilson, Price, Barranco, Blankenship & Billingsley, P.C. (CPAs), for each of the five years under examination. Audit reports and workpapers were made available to the examiners and were used where deemed appropriate in the completion of this examination.

ORGANIZATION AND HISTORY

The Company was incorporated on April 18, 1991, in Montgomery County, as a wholly-owned subsidiary of Baptist Ventures, Inc., an affiliate of the Baptist Health holding company system. As stated in the Company's Articles of Incorporation, the purpose of the Company organizing was to engage in the business of writing health and disability insurance policies, including, but not limited to the type defined as "medicare supplemental insurance."

From its incorporation through the date of this report, the Company has written only medicare supplement insurance. The Company has limited its territory to the area encompassing a 45 mile radius of Montgomery, Alabama. The Company commenced business on October 28, 1991, with paid up capital of \$500,000, and paid in surplus of \$750,000, derived from the sale of 2,500,000 shares of its \$.20 par value, common stock at \$.50 per share. The total authorized capital was \$1,000,000, consisting of 5,000,000 common shares at a par value of \$.20. There have been no changes in the authorized, issued or outstanding capital stock from the Company's inception through the date of this report.

The Company was not profitable during its first eight years of its existence. It has received several surplus contributions from its upstream affiliate in order to offset its losses and maintain the statutory capitalization as required by the Alabama Department of Insurance. However, for the years 2000, 2001 and 2002 the Company was profitable. The paid in and contributed surplus at December 31, 2002, amounted to \$3,804,843 and the unassigned funds deficit amounted to (\$2,165,569).

GROWTH OF THE COMPANY

The following schedule presents financial data, which reflects the growth of the Company for the years indicated:

<u>Year</u>	<u>Net Premium Written</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
1997	\$1,595,709	\$1,868,982	\$548,303	\$1,320,679
1998	1,716,112	1,562,924	630,118	932,806
1999	1,821,289	1,397,472	539,855	857,617
2000	2,105,853	2,122,092	388,718	1,733,374
2001	2,076,132	2,397,907	385,408	2,012,499
2002	\$1,653,771	\$2,397,169	\$257,895	\$2,139,274

Data for the years 1997 and 2002 are per examination. Data for the remaining years were obtained from the Company's Annual Statements.

HOLDING COMPANY AND AFFILIATES

Holding Company Registration and Reporting

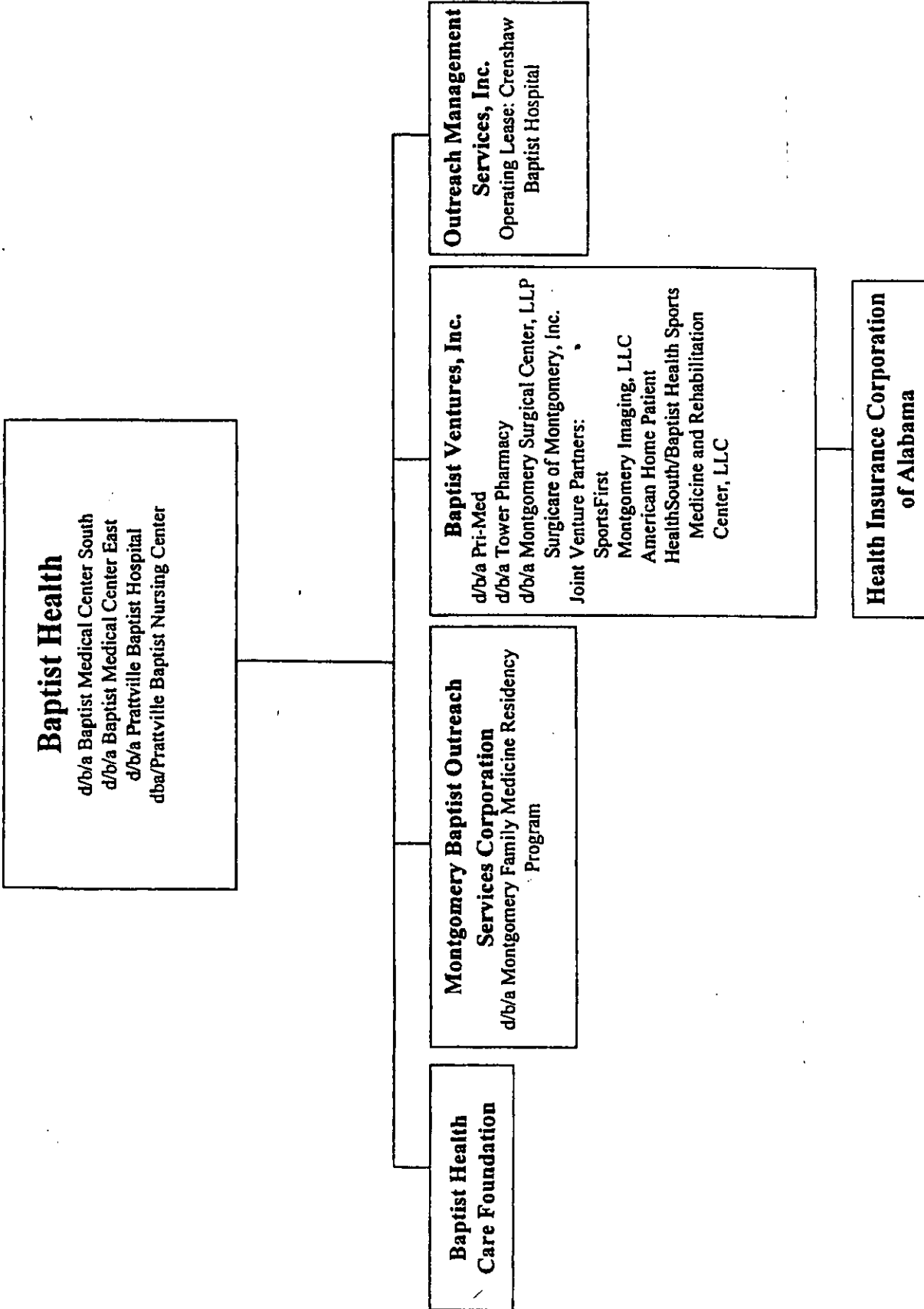
The Company was subject to the *Alabama Insurance Holding Company Regulatory Act of 1973*, as defined in ALA. CODE § 27-29-1, *Code of Alabama*, 1975. In connection therewith, the Company was registered with the ALDOI as Registrant of an Insurance Holding Company System. Appropriate filings required under the Holding Company Act were made from time to time by the Company. A review of certain Company filings completed during the period of the examination indicated that all required filings were not made in accordance with the aforementioned section of the *Alabama Insurance Code* and ALA. ADMIN. CODE 482-1-55 (2002).

The annual Form B Amendment for 2002 was reviewed and found to be substantially complete and to reflect the required disclosures. However, a discrepancy was noted in the fact that Mr. Jody Pigg signed the Form B in 2002 for the Company as being the Senior Vice President of the Company while on the Jurat page of the 2002 Annual Statement he signed as the Company's President. In the organizational chart included with the Form B filing for 2002, it lists Jody Pigg as being the Treasurer of the Company and Randall Hoover as the President of the Company.

Organizational Chart

The chart on the following page depicts the holding company system with which the Company was affiliated as of December 31, 2002.

(continued next page)



Agreements with Affiliates

See "Management and Service Agreements," page 8.

MANAGEMENT AND CONTROL

Stockholder

Baptist Ventures, Inc. (BVI) has been the sole stockholder of the Company since its incorporation in 1991. BVI is a wholly-owned subsidiary of Baptist Health, the ultimate controlling entity in the holding company system.

Board of Directors

The Company's By-laws provide that its Board of Directors (Board) shall be composed of not less than three, nor more than nine directors. The number of directors who are also directors of BVI shall not exceed 49%. Directors shall be appointed by the Stockholder for two-year terms, except that the President of the Company shall be an ex-officio, voting member of the Board. The By-Laws also provide that the President of the Company shall be the Chief Executive Officer of Baptist Health Services, Inc. (now known as Baptist Health).

The following persons were serving as directors of the Company at December 31, 2002:

<u>Director</u>	<u>Principal Occupation</u>
John Albert Holleman	Retired mortgage banker
David Scarborough Patrick	Senior Vice President, First Union Securities
Randall Lee Hoover	President and CEO, Baptist Health
Kay Kennedy Miller	Retired banker

All of the aforementioned directors were residents of Montgomery, Alabama.

As President of the Company, Mr. Hoover, was the ex-officio member of the Board, as is stipulated in the Company's By-Laws.

Mr. Holleman, Mr. Patrick, and Mrs. Miller were reelected by the Stockholder on October 22, 2001, but no minutes could be produced evidencing the fact that Mrs. Miller was ever originally elected as a director. This is in violation of the Company's By-Laws, Article Nine – Books and Records which states "The Corporation shall keep correct and complete books and records of account and shall also keep minutes of the proceedings of the Board, and committees having any authority of the Board."

It was noted that Mr. Hoover, Mr. Holleman, Mr. Patrick, and Mrs. Miller were also serving as directors of Baptist Health. This is apparently in conflict with Article Four, Paragraph 4.2 of the Company's By-Laws, which states "The Board of Directors shall consist of not less than three (3) nor more than nine (9) directors. The number who are also directors in Baptist Ventures, Incorporated, shall not exceed forty-nine percent (49%) of the number of directors of the Corporation."

Officers

The Company's By-laws provide that its officers shall be the Chairman of the Board, the Vice Chairman of the Board, the President, the Secretary and Assistant Secretaries, the Treasurer and such other officers as the Board shall deem advisable. The Chairman and Vice Chairman must be directors of the corporation. Officers, except for the President, shall be elected by the Board at its annual meeting and shall serve for one year, and until successors are elected and qualified.

The President of the Company shall be the Chief Executive Officer of Baptist Health. The President also has the authority to appoint a Chief Operating Officer and such other officers as shall be necessary for the orderly operation of the Company.

The following persons were serving as officers of the Company at December 31, 2002:

<u>Officer</u>	<u>Title</u>
John Albert Holleman	Chairman of the Board
David Scarborough Patrick	Vice Chairman of the Board
Jody Lewis Pigg	President
Benjamin Blaine Brown	Secretary
Diane Evans Scott	Treasurer

The preceding officers were elected by the Board on October 28, 2002. The Company's ByLaws state that the President of the Company shall be the Chief Executive Officer of Baptist Health. At December 31, 2002 the Chief Executive Officer of Baptist Health was Randall Hoover. The fact that Mr. Pigg is serving as the President of the Company is a violation of the Company's ByLaws which states that "the Chief Executive Officer of Baptist Health shall be the President of the Company."

Conflict of Interest

The conflict of interest policy of the Company as stated in its By-Laws, requires that any director, principal officer, or member of a committee with board delegated powers who has a direct or indirect financial interest in the Corporation is an interested person. If a person is an interested person with respect to any entity in the health care system of

which the Company is a part, he or she is deemed to be an interested person with respect to all entities in the health care system. If there is a possible conflict of interest, disclosure of the financial existence must be made to the Board; and, the Board shall determine whether a conflict exists.

In response to a request for conflict of interest statements applicable to the examination period, the examiner was provided with statements executed by some of the directors of the Company for the period of the examination. During the examination period three directors and none of the Presidents of the Company filled out a conflict of interest statement. No conflict of interest statements were provided for any of the officers of the Company who had access to the assets of the Company.

Management and Service Agreements

The Company has operated without personnel of its own since its inception. Company operations have been performed by personnel with Baptist Health (BH), Montgomery, Alabama, and Olympic Health Management Systems, Inc. (OHMS), Bellingham, Washington. This has been facilitated by means of the following agreements between the Company and the parties specified.

BH - Accounting/Administrative Services Agreement

This agreement was effective October 1, 1991, and is automatically renewed annually, unless terminated by either party upon 60 days written notice.

The agreement provides for BH to process the payment of all operating expenses of the Company, maintain the general ledger of the Company, book transactions generated by the Company's third party administrator, OHMS, reconcile the Company's bank statements, prepare quarterly and annual insurance reports for the NAIC and the ALDOI, provide general financial accounting services as needed, make all deposits of funds received and any administrative functions requested. The Company agrees to compensate BH for these services based upon an estimate of the direct costs of providing these services.

OHMS – the Company's third party administrator

This agreement became effective July 1, 1991. The agreement is unlimited in duration, but may be terminated at any time by mutual written consent of the parties with an agreed upon effective date of termination, or unilaterally by either party with a six month written notice to the other party.

The agreement provides that Olympic Health Management Systems (OHMS) will provide the Company with product line management and servicing of its medicare supplement insurance business. The responsibilities of OHMS include agent support, underwriting,

premium administration, electronic interface, claims administration and reporting functions. OHMS is compensated with a monthly fee of \$1,200.00, plus 12% of the premium income of the Company.

Also see "Accounts and Records," page 12, for discussion of certain Company records which were maintained by OHMS, outside the State of Alabama, which is a violation of Alabama statutes.

CORPORATE RECORDS

The Articles of Incorporation and By-laws, as amended, were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations.

Minutes of the meetings of the Stockholder and the Board of Directors from December 31, 1998 through the most recent meetings recorded were reviewed. The minutes that were provided were complete and adequately documented the actions of the governing bodies.

TERRITORY

Since the Company's inception, its territory has been limited to the area encompassing a 45 mile radius of Montgomery, Alabama. This area includes Montgomery County, Alabama, and portions of the surrounding counties.

At December 31, 2002, the Company was licensed by the Alabama Department of Insurance to write disability insurance. The Company has never been licensed in any other jurisdiction, and has no apparent plans to expand to other territories.

STATUTORY DEPOSIT

At December 31, 2002, in accordance with the statutory requirements for doing insurance business in the State of Alabama, the Company had the following deposit with the Alabama Department of Insurance: a U.S. Treasury Note, 2.75%, par, statement and fair values of \$105,000, due September 30, 2003.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2002, the Company did not have a fidelity bond. A crime policy in the amount of \$3,000,000, with a \$20,000 deductible with Baptist Health as the named insured was presented. This is unacceptable as the Company is not listed as an additional insured.

EMPLOYEE AND AGENTS WELFARE

All personnel were employees of Baptist Health, which provided services to the Company under the terms of the previously mentioned Accounting/Administrative Services Agreement. As a result of this agreement, the Company did not have a retirement plan, deferred compensation plan and/or other benefit plan.

The Company had only one active agent as of December 31, 2002.

MARKET CONDUCT

Plan of Operation

The Company markets only medicare supplement insurance.

The Company terminated its agency force in 1996, and since that time has accepted only new business from referrals and in small amounts. At December 31, 2002, and as of the date of this report, the Company had only one active agent.

Policy Forms and Underwriting

Since the Company incorporated in 1991, the Company has written business associated with four medicare supplement insurance plans. The policy forms for these four plans were approved by the Alabama Department of Insurance, in September of 1991.

In 1992, the Company amended its policy forms and submitted them to the Alabama Department of Insurance for approval and for the purpose of meeting the requirements of the newly enacted ALA. ADMIN. 482-1-71 (2002). This regulation was effective March 15, 1992, for the stated purposes of simplifying terms, standardizing coverage and facilitating public understanding associated with medicare supplement insurance.

The Company did not have evidence of the approval for the amended policy forms. The examiner was informed by the Alabama Department of Insurance, that the last

communication in the Company's file was dated August, 1993, and that the Company's amended policies had not been approved as of that date.

In conclusion, it appears that the Company may have been, since 1992, either issuing policies on forms which are not approved by the Alabama Department of Insurance, or issuing policies on forms which may not meet the requirements of ALA. ADMIN. 482-1-71 (2002).

Compliance with Agents' Licensing Requirements

The Company terminated its agency force in 1996. During 2002, and through the date of this report the Company has had only one active agent, who is on salary and did not receive any commissions.

Dividends to Policyholders

The Company has never issued dividend paying policies.

Advertising

The Company does not have a formal advertising program.

Claims Payment Practices

A sample of 47 claims files was inspected in order to evaluate the Company's claims payment practices. Claims were inspected in relation to payment timeliness, to compliance with policy provisions, and adequacy of documentation. No noteworthy discrepancies were found during the inspection of claims.

During the period of the examination, the Alabama Department of Insurance, Consumer Division and the NAIC Market Regulation Jumpstart – Complaints Index and Closed Complaint Data reported no complaints against the Company.

REINSURANCE

The Company has not assumed nor ceded any reinsurance during the period of its existence.

ACCOUNTS AND RECORDS

Internal Records

The Company's accounts and records are maintained primarily by Baptist Health (BH), in accordance with an Accounting/Administrative Services Agreement, previously discussed in "Management and Control," subsection, "Management and Services Agreement." The majority of the Company's source records relating to its insurance business are generated by its third party administrator, Olympic Health Management Systems, Inc. (OHMS) located in Bellingham, Washington, but the aforementioned agreement provides that BH is responsible for booking these transactions. Virtually all the records were computer generated, except for checks and application files. The Company is able to access some of their records electronically through a computer network.

Application files, claims files and the claims register were not maintained in the Company's home office. Selected samples of these files were requested and transferred from OHMS in Bellingham, Washington to the Company's home office in Montgomery, Alabama so they could be examined and reviewed. ALA. CODE § 27-27-29(a) (1975), requires that insurers maintain complete records within the State of Alabama. Also, it is a violation of ALA CODE § 27-27-29(c) (1975), to remove these records from the State of Alabama without the prior written permission of the Commissioner of the Alabama Department of Insurance.

Also see "Management and Service Agreements," page 8, for further discussion of the relationship between the Company, its parent, BH, and the Company's third party administrator, OHMS.

External Audits and Actuarial

The Company is audited annually by the certified public accounting firm of Wilson, Price, Barranco and Billingsley, of Montgomery, Alabama. The examiner obtained the audit reports for the years under examination, and discussed the Company's audits with the partner in charge of the audit work. It was deemed that reliance upon the external audit work would not be cost efficient for examination purposes, due to the small size of the Company and the anticipated short span of the examination.

The Company's reserves were certified and its Actuarial Opinions were rendered, for the years under examination, by Milliman and Robertson, Inc. located in Seattle, Washington.

FINANCIAL STATEMENTS

Financial statements included in this report, which reflect the operations of the Company for the years under examination and its financial condition at December 31, 2002, consist of the following:

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**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS ARE
AN INTEGRAL PART THEREOF.**

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Year Ended December 31, 2002

	<u>ASSETS</u>			
	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Non-Admitted Assets</u>	<u>Admitted Assets</u>
Bonds (Note 1)	\$ 1,851,236			\$ 1,851,236
Cash	531,675			531,675
Investment income accrued	14,258		-	14,258
Prepaid insurance	16,976	-	16,976	-
Total Assets	<u>\$ 2,414,145</u>	<u>\$ -</u>	<u>\$ 16,976</u>	<u>\$ 2,397,169</u>

LIABILITIES SURPLUS AND OTHER FUNDS

Liabilities

Policy and contract claims - a & h (Note 2)	\$ 200,000
Aggregate reserve for a & h contracts (Note 3)	32,876
General expenses due or accrued	37,936
Payable to parent (Note 4)	<u>(12,917)</u>
Total Liabilities	\$ 257,895

Surplus and Other Funds

Common capital stock		\$ 500,000
Gross paid in and contributed surplus (Note 5)	\$ 3,804,843	
Unassigned funds (deficit) (Note 6)	<u>(2,165,569)</u>	
Total surplus		<u>1,639,274</u>
Total capital and surplus		<u>2,139,274</u>
Total Liabilities, Surplus and Other Funds		<u>\$ 2,397,169</u>

COMPARATIVE SUMMARY OF OPERATIONS

For the Years Ended December 31,

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<u>Income:</u>					
Premium considerations	\$ 1,653,771	\$ 2,076,132	\$ 2,105,853	\$ 1,821,289	\$ 1,716,112
Net investment income	61,242	112,870	115,256	77,979	96,587
Miscellaneous income	11	929	5,299	-	1,029
Total income	<u>\$ 1,715,024</u>	<u>\$ 2,189,931</u>	<u>\$ 2,226,408</u>	<u>\$ 1,899,268</u>	<u>\$ 1,813,728</u>
<u>Deductions:</u>					
Benefits under accident and health policies	\$ 1,097,538	\$ 1,371,900	\$ 1,345,941	\$ 1,539,279	\$ 1,895,187
General insurance expenses	465,114	507,856	476,459	407,704	358,723
Insurance taxes, licenses and fees	20,272	29,983	28,246	24,444	23,395
Aggregate write-in for deductions	-	-	-	3,037	-
Total deductions	<u>\$ 1,582,924</u>	<u>\$ 1,909,739</u>	<u>\$ 1,850,646</u>	<u>\$ 1,974,464</u>	<u>\$ 2,277,305</u>
Federal income taxes incurred	\$ -	\$ -	\$ -	\$ -	\$ -
Net Income (Loss)	<u>\$ 132,100</u>	<u>\$ 280,192</u>	<u>\$ 375,762</u>	<u>\$ (75,196)</u>	<u>\$ (463,577)</u>

RECONCILIATION OF CAPITAL AND SURPLUS

For the Years Ended December 31,

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Capital and surplus, January 1	\$ 2,012,499	\$ 1,534,583	\$ 857,617	\$ 932,806	\$ 1,404,786
Net income	\$ 132,100	\$ 280,192	\$ 375,762	\$ (75,196)	\$ (463,577)
Change in non-admitted assets	(5,317)	197,731	(198,791)	1	(8,404)
Paid in surplus	-	-	500,000	-	-
Aggregate write-in for gain/loss in surplus	(8)	(7)	(5)	6	1
Change in capital and surplus during year	\$ 126,775	\$ 477,916	\$ 676,966	\$ (75,189)	\$ (471,980)
Capital and surplus, December 31	\$ 2,139,274	\$ 2,012,499	\$ 1,534,583	\$ 857,617	\$ 932,806

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Bonds

\$1,851,236

The amount of the captioned asset is the same as reported in the Company's 2002 Annual Statement and is comprised totally of U.S Treasury securities. The Company could not provide supportive documentation of the purchases and sales of its securities which transpired during the examination period.

Note 2 – Policy and Contract Claims – Accident and Health

\$200,000

The amount of the captioned liability is the same as reported in the Company's 2002 Annual Statement. This amount represents an estimate that was computed utilizing historical claims triangle information based on claims paid through January 31, 2003. The \$200,000 figure included an additional margin to the figure recommended by the Company's consulting actuary.

Note 3 – Premium for A & H Contracts Received in Advance **Aggregate Reserve for A & H Contracts**

\$ -0-
\$32,876

The Company calculated its unearned premium reserve as of December 31, 2002, to be \$32,876 and reported this liability under the "Premiums for accident & health contracts received in advance" in its 2002 Annual Statement. This has been reclassified in accordance with *SSAP No. 54* which states that unearned premium reserves shall be required for all accident and health contracts for which premiums have been reported for a period beyond the date of valuation other than premiums paid in advance.

Note 4 – Borrowed Money **Payable to Parent, Subsidiaries and Affiliates**

\$ -0-
(\$12,917)

The amount reported is the result of an intercompany financial relationship between the Company and Baptist Health which is governed via an accounting/administrative services agreement between the parties.

The amount should have been reported in the Annual Statement under the liability caption "Payable to parent, subsidiaries and affiliates," and has been reclassified in accordance with *NAIC Annual Statement Instructions* and *SSAP 67* as the Company did not borrow money from its parent. The (\$12,917) was an intercompany balance and no interest was being charged.

Note 5 – Gross Paid in and Contributed Surplus**\$3,804,843**

The amount of the Company's gross paid in and contributed surplus is primarily the result of numerous surplus contributions received from the parent company, during the period of the Company's existence. These surplus contributions have been necessary to maintain the level of capital and surplus stipulated by Alabama statutes. Surplus contributions received during the period under examination amounted to \$500,000. This infusion of surplus took place in 2000.

Note 6 – Unassigned Funds (deficit)**(\$2,165,569)**

The captioned amount is the same as is reported in the Company's 2002 Annual Statement.

No material exceptions were noted during the course of the examination. Therefore, no changes are reflected in the financial statements contained in this report.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The Company did not report any contingent liabilities or pending litigation that were deemed to have potential for material adverse effect on its surplus. The Company's Secretary executed a notarized letter of representation attesting to the non-existence of contested claims, unreported liabilities, and contingencies, as of December 31, 2002.

However, the examination revealed that the Company could be liable for fines by the Alabama Department of Insurance, as a result of violations of several Alabama insurance statutes. These violations relate to moving and maintaining records outside the State of Alabama without the prior written consent of the Commissioner of the Alabama Department of Insurance. Details of these violations are discussed in "Management and Service Agreements," page 8, and "Accounts and Records," page 12, respectively. The certainty of any fines, and amounts thereof, can not be determined as of the date of this report. However, fines in the maximum amounts permitted by the pertinent statutes would be material.

COMMENTS AND RECOMMENDATIONS**Holding Company Registration and Reporting – Page 4*****Finding:***

The examination revealed several errors in the Company's Reg. B filing.

Recommendation

It is recommended that the Company make all holding company filings and disclosures in accordance with ALA. CODE §27-29-4 and 5 (1975), and ALA. ADMIN. CODE 482-1-55 (2002). Further, the information contained within the filing should be accurate and represent the true nature of the business.

Board of Directors – Page 6

The Company's By-Laws specify that no more than 49% of its directors shall also be directors of its parent company. Of the four directors serving on the Company's board at December 31, 2002, all four were also directors of Baptist Health, the parent company.

Finding:

The Company violated its own By-Laws by having four out of four (100%) members of its board also serving as directors on the board of Baptist Health. The By-Laws restrict the amount to 49%.

Recommendation:

It is recommended that the Company make changes in the make up of its board of directors or approve amendments to its bylaws in order for the board membership to comply with the bylaws as written.

Finding:

In the review of the board of directors' minutes, it was evidenced whereby the Board of Directors reelected Mrs. Kay Miller. However, the Company could not produce evidence whereby Mrs. Miller was originally elected to the Board of Directors. This is a violation of the Company's By Laws Article VI (D) which states, "The number of directors may be increased or decreased by resolution adopted by a majority of the directors" Also, it was not evidenced that the Company called a special meeting to appoint Mrs. Miller to the Board. This is in violation of ALA. CODE § 27-27-24 (1975) which states that "At a special meeting.....vacancies in the board of directors may be filled by the remaining members of the board, and each person so elected shall be a director until his successor is elected by the stockholders or members at the next annual meeting of stockholders.....".

Recommendation:

It is recommended that the Company's Board of Directors approve, with a majority vote, all increases or decreases in the membership of its Board of Directors as set forth in the Company's By-Laws.

It is also recommended that the Company's Boards of Directors approve the filling of vacancies to the Board as prescribed by ALA. CODE § 27-27-24 (1975).

Conflict of Interest – Page 7

Finding:

Conflict of interest statements were completed only for the Board of Directors of HICA . These statements covered the period of the examination, however, they did not include conflict of interest statements on key management personnel (President and Treasurer of the Company) who are responsible for the assets of the Company.

Recommendation:

It is again recommended that the Company review its conflict of interest policy to determine it is comprehensive enough to meet the needs of the Company.

This recommendation was also recommended in the previous examination report.

Management and Service Agreements - Page 8

Finding:

The third party administrator, Olympic Health Management Systems (OHMS) is acting as an unlicensed managing general agent for the Company. This is a violation of violation ALA. CODE §27-6A-3 (1975). The Company pays OHMS a monthly fee of \$1,200 plus a 12% commission of its premium income. This is a violation of ALA. CODE § 27-8-27 (1975) for an insurer to pay commissions to an unlicensed agent.

Recommendation:

It is again recommended that the Company pay commissions only to agents who are licensed by the Alabama Department of Insurance, in compliance with ALA. CODE §27-6A-3 (1975) and ALA. CODE § 27-8-27 (1975).

Fidelity Bond – Page 10

Finding:

The Company could not provide a Fidelity Bond listing the Company as the named insured. They provided a Crime Policy which listed the Company's upstream parent as the named insured. However, the Company's name was not listed on the declarations page nor was it found elsewhere as an endorsement or separate rider. Even though the coverage amounts appeared to be sufficient, this is not acceptable as the Company is not listed as a named insured.

Recommendation:

The Company should provide a Fidelity Bond listing the Company as the named insured with sufficient coverages to meet the needs of the Company as prescribed in the Financial Condition Examiners Handbook.

Policy Forms and Underwriting – Page 10

It appears that the Company has, since 1992, either issued policies on forms which are not approved by the Alabama Department of Insurance, or issued policies on forms which may not meet the requirements of Departmental *Regulation Number 71*.

Finding:

It was noted that the Company did not meet the requirements of ALA. ADMIN. CODE 482-1-71 (2002) which became effective July 1, 1992.

Recommendation:

It is again recommended that the Company determine the status of its policy forms, and take whatever action may be necessary to assure that its policy forms are in compliance with Alabama Regulation Number 71 and meet the approval by the Alabama Department of Insurance.

Compliance with Agents Licensing Requirements – Page 11

See the recommendation under the heading "Management and Service Agreements," page 22.

Accounts and Records – Page 12

Finding:

The Company is maintaining its claims register for the years 1998-2002 outside the state of Alabama. The Claims register is maintained by the Company's third party administrator, Olympic Health Management Systems in Bellingham, Washington. This is a violation of ALA. CODE § 27-27-29 (1975), with relation to moving and maintaining certain of its records outside the State of Alabama without the prior written consent of the Alabama Department of Insurance.

Recommendation:

It is recommended that the Company comply with ALA. CODE § 27-27-29 (1975) by maintaining all its records within Alabama or by obtaining the approval of the Alabama Department of Insurance to continue its current practice. This was also a recommendation in the previous examination.

Finding:

The Company was requested to provide the purchase and sale confirmations relating to all security transactions from January 1, 2001 through December 31, 2002. The Company could not provide the aforementioned records requested as is required by ALA. CODE§ 27-27-29(a) (1975) which statesevery domestic insurer shall have and maintain its principal place of business and home office in this state and shall keep

therein complete records of its assets, transactions and affairs..... Also, the fact that the Company could not provide these records as is required by ALA. CODE § 27-27-30 (1975) which states that "No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money."

Recommendation:

It is recommended that the Company maintain complete and accurate records of its business affairs as set forth in ALA. CODE § 27-27-29(a) (1975) and ALA. CODE § 27-27-30 (1975).

Finding:

The Company files a consolidated income tax return with its parent and the Company did not have a written tax allocation agreement as prescribed by ALA. CODE § 27-29-4 (h) (1975) which states "Every insurer subject to registration shall file a registration statement on a form provided by the commissioner which shall contain current information about:(h) Consolidated tax allocation agreements."

Recommendation:

It is recommended that the Company develop a written tax allocation agreement with its affiliates as prescribed in ALA. CODE § 27-29-4 (h) (1975).

Payable to Parent, Subsidiaries, and Affiliates – Page 17

Finding:

The 2002 year-end balance of (\$12,917) under L.22 Borrowed Money represents an overpayment of the intercompany balance due to the parent company (Baptist Health) from the Company. The reporting of this under the caption Borrowed Money is a misclassification--it should have been reported under Payable to parent, subsidiaries and affiliates. Since Baptist Health is the sole stockholder of the Company, this (\$12,917) is actually a prohibited investment made by the Company and is a violation of ALA. CODE § 27-41-36(a) (1975) which states that "an insurer shall not invest in or lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer...." The amount of (\$12,917) is immaterial and no adjustment will be made to the annual statement.

Recommendation:

It is recommended that the Company not lend money to its parent which is a violation of ALA. CODE § 27-41-36(a) (1975).

Gross Paid in and Contributed Surplus – Page 18

The Company did not have a profitable year during its first eight years of existence. However, for the past three years, the Company has maintained a profit. The Company ceased to solicit new business during the latter part of 1996, and has not resumed solicitation as of the date of this report. Premium income trended upward since 1997 for the next four years and peaked in 2001, and then began to fall in 2002. During the same period, claims payments decreased significantly by nearly \$1,000,000.

Contingent Liabilities and Pending Litigation – Page 18

The Company could be liable for fines in relation to violations of certain Alabama insurance statutes. The amounts and certainty of any fines and the amounts cannot be determined as of the date of this report. However, if the maximum fines should be imposed, the total amount could be material.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

Holding Company Registration and Reporting

The preceding report of examination also recommended that the Company make all holding company filings and disclosures in accordance with ALA. CODE § 27-29-4 and 5 (1975) and ALA. ADMIN. 482-1-55. The examination noted that the names on the Company's filings did not match information contained on the Jurat page of the Annual Statement.

Board of Directors

The Company's By-Laws stipulate that no more than 49% of its directors shall also be directors of its parent company.

The preceding report of examination recommended that the Company amend its By-Laws, or make changes in the composition of its Board of Directors, in order to comply with its By-Laws as written. The Company did not amend its By-Laws for this nor did it change the composition of its Board of Directors in order to abide by its By-Laws. In fact, the examination revealed that all four of the board members or 100% are also board members of the parent company.

Conflict of Interest

The previous examination report recommended that the Company review its conflict of interest policy to determine if it is comprehensive enough to meet the needs of the Company, and to determine if it is being properly implemented. This examination revealed that the Company had obtained conflict of interest statements on its Board of

Directors on an annual basis but did not obtain conflict of interest statements on its officers and other key personnel responsible for the Company's assets.

Management and Services Agreement

The preceding report of examination recommended that the Company pay commissions only to agents who are licensed by Alabama Department of Insurance. This examination revealed that the Company is still paying commissions to this same unlicensed agent.

Policy Forms and Underwriting

The previous examination report recommended that the Company determine the status of its policy forms, and take whatever action that may be necessary to assure that its policy forms are in compliance with ALA. ADMIN. 482-1-71 (2002). The examination revealed that the Company is using the same policy forms and are still in violation of the aforementioned regulation.

Accounts and Records

The prior report of examination recommended that the Company maintain all its records in Alabama, or obtain the Commissioner's approval for its current practice. The findings of the examination revealed that the Company is still in violation of ALA. Code § 27-27-29 (1975) in that it has moved, and is maintaining certain of its records outside the State of Alabama without the prior written consent of the Commissioner of the Alabama Department of Insurance.

SUBSEQUENT EVENTS

The Company's parent recently underwent some key changes in management personnel. In September, 2003, Jody Pigg resigned as Senior Vice President of Baptist Health and in November, 2003, Diane Scott resigned as Baptist Health's Vice President of Finance. Mr. Pigg was serving in the capacity as the President of the Company and Ms. Scott was serving as its Treasurer.

In March, 2004, Randall Hoover, the President of Baptist Health and Patti Gardes, the Treasurer of Baptist Health, resigned. Mr. Hoover was serving in the capacity as the President of the Company and Ms. Gardes was serving as the Treasurer. It was at this time that Baptist Health entered into a management agreement with the University of Alabama-Birmingham Health System (UAB). In the agreement, UAB agrees to provide management services through personnel provided by UAB.

Russell Tyner was appointed as President of Baptist Health and will serve as President of the Company. Richard Humphrey was appointed as Director of Finance for Baptist Health and will serve as the Company's Treasurer. Other management positions will be filled in the near future.

For the past several years the Company has not actively pursued new business and in November, 2003, the Company ceased writing any new business completely. At December 31, 1997, the Company had 1,936 medicare supplement contracts in force and at March 31, 2004 there were 686 remaining (a 65% decrease).

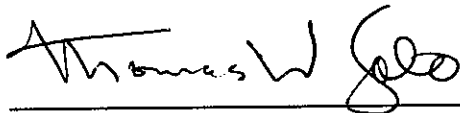
CONCLUSION

In concluding this Report on Examination, as of December 31, 2002, of Health Insurance Corporation of Alabama, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Matt McAllister, FSA, MAAA, participated in this examination as consulting actuary for the Alabama Department of Insurance.

Respectfully submitted,
May 3, 2004 .

A handwritten signature in black ink, appearing to read "Thomas W. Salo", written over a horizontal line.

Thomas W. Salo, Examiner II
Examiner - in - Charge
Alabama Department of Insurance